Prepared Statement of Sir David Tweedie,
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to Economic and Monetary Affairs Committee, European Parliament

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Madam Chairwoman, Members of the Economic and Monetary Affairs (ECON) Committee, I welcome this opportunity to appear before you today to present how we at the International Accounting Standards Board (IASB) are responding to issues arising from the financial crisis. I will focus my formal remarks on our response on the financial crisis and, in particular, our response to issues raised by EU institutions. However, I should be happy to discuss any other issues that members of the Committee wish to raise.

I am particularly pleased that you have made time to allow me to provide an update on the IASB's work at this critical juncture for financial markets. I and my colleagues on the IASB look forward to working with the Committee in the coming years, and we remain committed to seeking your input on important aspects of our work at an early stage in the decision-making process. I also know that the Trustees of the IASC Foundation, the IASB's oversight body, have already expressed their willingness to meet the Committee later this year.

This session is particularly timely. The G20 leaders met last week and have repeatedly affirmed the importance of achieving a single set of high quality global accounting standards. This is something that the European Union and your predecessors on this Committee recognised well in advance of the current crisis. The European Union's strategy to adopt an international standard, rather than a particularly European one, has been vindicated. As a direct result of your leadership in this area, over 100 countries now require or permit the use of the International

Financial Reporting Standards (IFRSs) issued by the IASB. It is crucial for the achievement of global standards and the effective functioning and prosperity of the European economy, and indeed the global economy, that the EU remains committed to global standards.

An active and measured response to the financial crisis

Today, in the limited time that we have for this session, I should like to explain what we have already done and what we are currently doing in response to the financial crisis. It is a priority of the IASB to keep EU institutions – and other relevant stakeholders - informed of our activities. I would certainly welcome your views today. Earlier in the year, I had the opportunity to meet with EU Finance Ministers in June and I have been invited to their October meeting to provide a further update. We are also in regular contact with the European Commission. I am also including, as part of my written statement, a copy of a letter that Gerrit Zalm, the Chairman of the IASC Foundation Trustees, sent to the G20 on 15 September that describes our actions in greater detail.

Today, I want to give members of this Committee confidence that the IASB has responded appropriately to the crisis and to the specific issues raised in Europe. Last week, the Monitoring Board, in which the European Commission currently participates, set out important principles to guide our response to the financial crisis. The Monitoring Board emphasised, 'the primary objective of financial reporting as being to provide information on an entity's financial performance in a way that is useful for decision-making for present and potential investors. To be considered decision-useful, information provided through the application of the accounting standards must, at a minimum, be relevant, reliable, understandable and comparable.'

These are principles that we have applied and will continue to apply in response to the financial crisis.

In developing an effective response to the crisis, the IASB has sought the advice of experts from a wide range of backgrounds. Jointly with the US Financial Accounting Standards Board (FASB), we asked the Financial Crisis Advisory Group (FCAG), a group of leaders with broad experience in international financial markets to advise the two boards on their joint response to the crisis. Prominent European members of this group include Hans Hoogervorst, Chairman of the AFM (the Netherlands Authority for the Financial Markets), Stephen Haddrill, Director General of the Association of British Insurers (ABI) and shortly to become Chief Executive of the UK Financial Reporting Council (FRC), Michel Prada, former Chairman of the Autorité des Marchés Financiers (AMF), Tommaso Padoa-Schioppa, former Finance Minister of Italy, Klaus-Peter Müller, Chairman of the Supervisory Board of Commerzbank, and Lucas Papademos, Vice-President of the European Central Bank.

The FCAG reported at the end of July, and the IASB is working to implement the relevant recommendations.

Actions taken to respond to global concerns

From the outset of the crisis, the IASB has worked on a defined programme with time lines to address issues arising from the financial crisis. Our initial focus was on the three areas identified by the Financial Stability Forum: 1) the application of fair value in illiquid markets; 2) accounting for off balance sheet items; and 3) disclosures related to risk. On all three points, we have acted urgently.

On fair value in illiquid markets, we produced a report in October 2008 that the European Commission praised. We have consistently stated that IFRS and US guidance are consistent in this important area. I know that there was concern that the recent FASB Staff Position on fair value measurement might have created a new unlevel playing field. It is for this reason that immediately after the FASB's publication, we posted a press release reiterating that our approach was consistent with the FASB's. As an extra precaution to ensure that global consistency is maintained, on 28 May 2009 the IASB published an exposure draft on fair value measurement that directly incorporates the relevant FASB guidance

On off balance sheet items, the G20, the Financial Stability Forum, and this Council have all emphasised the need for more transparency in the accounting for these items. There is some evidence that IFRSs have held up relatively well on this issue, but we have now proposed tightening our rules further.

On risk disclosures, in March 2009 the IASB published improvements to the disclosure requirements for fair value measurements and reinforced existing principles for disclosures about the liquidity risk associated with financial instruments.

Response to European Union concerns

The IASB also recognises the importance of concerns raised primarily in Europe, particularly regarding the possibility of an unlevel playing field for US and European financial institutions. The European Commission has articulated those concerns in letters sent to the IASB.

The IASB acted on each of the four issues raised by the European Commission, on behalf of Member States and EU stakeholders, in the fourth quarter of last year. The Commission called for a standard-setting response on the following issues: (1) the need for guidance about fair value measurement in illiquid markets; (2)

the desire for clarification regarding whether credit derivative obligations (CDOs) include embedded derivatives to ensure consistency between IFRSs and US GAAP; (3) the existing impairment rules related to available-for-sale instruments; and (4) the possibility of reclassification out of the fair value option into other categories.

As I explained earlier, we have completed work on fair value in illiquid markets.

We are working with the US standard-setter, the FASB, to ensure consistency in the accounting of embedded derivatives. The FASB has now developed a proposed clarification that is expected to be in place for the 2009 financial statements.

This leaves us with the issues of the impairment rules and reclassification out of the fair value option. These are the issues, particularly impairment, on which Council and the European Commission recommended urgent action. Our original plan, based upon views expressed by stakeholders in Europe and elsewhere, was to resolve these two issues through a comprehensive revision of IAS 39. This has always been a priority.

It was for this reason that on 1 April we announced that we would undertake an urgent six-month project to produce a proposal aimed at a comprehensive revision of IAS 39 *Financial Instruments: Recognition and Measurement*. We were pleased that the G20, at its London summit the next day, called on standard-setters 'to reduce the complexity of accounting standards for financial instruments'.

However, actions taken by the US FASB changed our position. In April, the US FASB issued Staff Positions (FSPs) regarding fair value measurement and impairment. This caused the IASB to accelerate the timing of the approach announced on 1 April. We have now made our priority – in advance of other topics covered in the IAS 39 replacement – the part of the comprehensive project concerning classification, measurement and related impairment issues.

Giving these matters priority responds directly to the concerns raised by EU Finance Ministers. As you know, at the June ECOFIN Council meeting, I affirmed the IASB's commitment to have the accelerated portion of the project completed for use by year end.

We are on track to meet that commitment. In July, the IASB published an exposure draft on a new standard that will address the impairment and reclassification issues raised by the Commission. The exposure draft allowed two months for public comment to ensure that the IASB's conclusions follow a transparent and open due process that considers the views of all stakeholders. The comment period has now ended, and we have received letters from more than 200 individuals and organisations. Additional board meetings have already been held, and will continue to be scheduled as required to complete the project in time for the 2009 financial year.

To help ensure broad international acceptance and the quality of our solution, the IASB has taken unprecedented, but welcomed, steps to consult widely. We have held meetings with investors, prudential supervisors, capital market authorities and other stakeholders in Europe and elsewhere and held international round tables in Asia, Europe and the United States.

This timeline will also ensure that due process for endorsement is available at the European level. We will work with all relevant bodies (such as EFRAG, the

European Parliament, the European Commission, and the Council) to facilitate a smooth endorsement process.

There are a couple of points that I should like to emphasise regarding the IASB's proposals on classification and measurement. First, the proposals to revise IAS 39 on which the IASB is now consulting globally provide for a significant reduction in the complexity of financial instrument accounting—a goal highlighted at the April 2009 G20 Leaders Summit in London. Second, the proposals are also consistent with the view of many stakeholders, including the Basel Committee, that cost-based accounting is appropriate for some categories of financial instruments. In order to provide transparency and reflect economic reality, the IASB's emphasis has been to define in a balanced and transparent way the appropriate criteria for classifying instruments to be measured at cost and fair value—not to increase or decrease arbitrarily the use of fair value.

Whether there is a decrease or an increase of fair value will depend on a particular institution's business model and holdings. The IASB is not proposing that the loan book of banks should be held at fair value. As a result, we expect that banks primarily engaged in the traditional activities of deposit-taking and making basic loans are likely to make less use of fair value. Those involved in trading, or who make use of more complex financial instruments such as derivatives, may see a greater use of market pricing, which most investors feel is appropriate.

We believe that our approach is a superior one to one that would merely adopt the US FASB Staff Position on impairment for the following reasons. First and foremost, our work on impairment directly addresses the specific nature of EU stakeholder and EU institutional concerns. Second, our approach responds directly to the G20's call for reduced complexity. The proposal will see a much-needed reduction in the number of categories of financial assets and will leave us with a single impairment method. Third, the proposal anticipates future problems associated with reclassifications by replacing restrictive tainting rules affecting held-to-maturity securities with measures aimed at transparency. Fourth, the transition would allow a reclassification out of the fair value option into other categories. Lastly, a comprehensive solution avoids the confusion and cost that would arise from repeated changes in reporting requirements. In this economic environment we recognise that this unnecessary cost would not be welcomed by most financial and non-financial companies.

There has been a suggestion by some that we should take more time to develop the new financial instruments standard. In the interim, some have suggested adopting the US standard. We reject this suggestion on two grounds. First, stakeholders in the European Union have warned against blindly adopting US standards. Indeed, your predecessors on this Committee questioned the adoption of IFRS 8 *Operating Segments* a few years ago on that ground. We at the IASB do not want to be necessarily bound to US standards, when we believe that there is a better way to secure the confidence of international capital markets and investors.

Second, I stress that if we adopted the FASB FSP, this would neither create a level playing field, nor put an end to the level playing field question. This is a fundamental point that deserves underlining here. Our impairment rules are very different. On many issues EU financial institutions would not want us to adopt the US approach on impairment. For example, we permit reversals of losses in a number of instances, where the US does not. Impairments under IFRSs have different triggers from those in US GAAP. It is for this reason that even today, after the change made by the FASB, some in the US are arguing that EU banks have a competitive advantage.

I also wish to assure you that in addition to the priority given to the issue above, the IASB will continue its work on other issues raised by the G20 and the Council. The IASB is improving the accounting for loan-loss provisions and will publish a formal proposal in October. The IASB is working closely with prudential supervisors, financial institutions, investors and other stakeholders specifically to develop more forward-looking measures (an expected loss model rather than the incurred loss model currently in place in IFRS and US GAAP). We will have an exposure draft on hedge accounting shortly thereafter.

Clearly, the work that we are doing on the IAS 39 replacement requires extensive, transparent and open consultation. We are working hard to ensure that the views of all stakeholders, including this Committee, ECOFIN, central banks and prudential supervisors among others, are taken into account. Comment letters received in response to the IAS 39 consultation would appear to indicate that this effort is very much appreciated.

In the meantime, I can assure this Committee that the IASB is committed to the work programme it has laid out. In the limited time available today I have restricted my comments to matters relating to the financial crisis. But as you may be aware, the IASB also has a number of other important projects on its agenda that will undoubtedly be of interest to your constituents. These include the accounting for pensions, leases and insurance contracts and the use of interactive data, otherwise known as XBRL. I also recognise that in some cases you may be asked to form a view on what can be technical or highly complex issues. For this reason I and my staff stand ready to provide whatever assistance may be required in the form of additional briefings, background material or simply at the end of the phone.